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No. 854

In the Supreme Court of the United States

OCTOBER TERM, 1962

[illegible]

Petitioner,

v.

[illegible]

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

[illegible]

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 534

THE MORRIS PLAN COMPANY OF CALIFORNIA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1–45), including the opinion on denial of taxpayer's petition for rehearing (Pet. App. 61–62), is reported at 305 F. 2d 610. The Tax Court findings of fact and opinion (Pet. App. 46–60) is reported at 33 T.C. 720.

JURISDICTION

The judgment of the court of appeals was entered on May 22, 1962. (Pet. App. 68; R. 315.) Taxpayer's petition for rehearing was denied on June 29, 1962. (Pet. App. 62; R. 316.) By order of Mr. Justice Black, the time for filing a petition for a writ of certiorari was extended to and including November 26, 1962. The petition for a writ of certiorari was

filed October 18, 1962. Jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

1. Whether the indebtedness of a Morris Plan company evidenced by thrift certificates constitutes borrowed capital or bank deposits for the purpose of computing its excess profits tax credit under the Excess Profits Tax Act of 1950.[1]

2. Whether leasehold improvements constitute "facilities" for the purposes of computing an alternative excess profits tax credit under the 1950 Act.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 104(a), 436, 437, 439 and 444 of the Internal Revenue Code of 1939, and Treasury Regulations 130, Section 40.439–1, are printed in the Appendix, *infra*, pp. 13–17.

STATEMENT

The tax years in issue are 1950, 1951 and 1952. The taxpayer here, like the taxpayer in No. 447, is a California industrial loan company, engaged in the same business of making small loans and discounting notes and purchase contracts. (Pet. App. 47) It issued several types of thrift certificates—including definite term, fully paid up, unit (issued in multiples of $100), and installment thrift certificates of $1 or multiples thereof. (Pet. App. 49–50.) Taxpayer

[1] This is the sole question presented in *Valley Morris Plan v. Commissioner*, No. 447, now pending on petition for writ of certiorari. The facts in both cases are essentially the same and the brief in opposition in No. 447 sets forth the Government's argument in full.

also borrowed from banks, but the installment thrift certificates were its main source of funds. (Pet. App. 51.)[2]

The interest rate on installment thrift certificates was 2% or 2½% in 1950 and the first three months of 1951, and thereafter 3%, except that 4% was paid on certificates issued to employees, of which $190,372.71 was the largest amount outstanding in any taxable year. The prevailing interest rate paid by banks on commercial savings accounts was 1% to 1½% in 1950 and 2% in 1951 and 1952. (Pet. App. 49–50.) The certificates were transferable and could be assigned for collateral, but were not traded in any market or exchange. Any certificate could be redeemed in part or in full at any time, as the taxpayer did not seek to enforce the restrictions on withdrawals. (Pet. App. 50.)

The installment certificates were issued in passbook form to record purchases and withdrawals. As the court below noted, quoting from the testimony of taxpayer's president, an installment thrift account was opened and deposits and withdrawals made according to the same procedure which is followed in the case of bank deposits. (Pet. App. 32–33.) Like the taxpayer in No. 447, taxpayer here is regulated by the California

[2] The average daily balances were as follows (Pet. App. 51):

	Year 1950	Year 1951	Year 1952
Installment Certificates	$13,000,000	$16,000,000	$23,000,000
Unit Thrift Certificates	3,000,000		
Installment Investment Certificates (employees)	146,000	160,000	176,000
Definite Term Thrift Certificates	266,000	474,000	842,000
Full Paid Investment Certificates	1,800	1,800	1,800
Bank loans	345,890	633,562	461,252

Department of Investment, Division of Corporations. In order to issue certificates it must apply for a permit, setting forth the specific amount and specific terms of the intended issue and furnishing complete financial data. Its loans are governed by stringent regulations, limiting the interest rate, the term and the security. It is required to file detailed annual reports with the Division, including a financial statement and an analysis of surplus. (Pet. App. 47–48.) In addition, it is subject to at least an annual audit and where it is conducting its affairs in an unsafe or injurious manner, the Commissioner of Corporations may take possession of and liquidate a company in the same manner as it may liquidate a bank. California Financial Code, 30 West's Annotated California Codes, Division 7, Sections 18804; 18815–18820.

The taxpayer's advertising is supervised by the Commissioner of Corporations, who enforces a state prohibition against the use of the name bank or bank deposits. Taxpayer, however, advertises its membership in the American Bankers Association, Consumer Bankers Association (successor to Morris Plan Bankers Association), and the American Industrial Bankers Association. (R. 180–181, 211, 235.) The advertising also describes the investment certificates as "accounts". (R. 184.) Taxpayer is in competition with banks and savings and loan companies for the money of the account holders. (R. 200.) It is not now and has never been a member of any Federal Reserve Bank or of the Federal Reserve System, nor an insured bank of the Federal Deposit Insurance

Corporation. (R. 140.) Some California banks do not have their deposits insured by the Federal Deposit Insurance Corporation and are not members of the Federal Reserve System. (R. 245.)

On these facts the Tax Court held that the taxpayer was not a bank and its installment thrift certificates, like the term thrift certificates involved in *Valley Morris Plan* v. *Commissioner*, No. 447, were not certificates of deposit, but instruments having the general character of investment securities issued by a corporation, within the meaning of Treasury Regulations 130, Section 40.439–1, Appendix, *infra*, p. 17. (Pet. App. 56–60.) The court of appeals reversed, holding that the taxpayer was a bank within the commercial and dictionary meaning of the term, as well as the definition of a bank for income tax purposes in Section 104(a) of the Revenue Code Appendix, *infra*, p. 13, and that the certificates were certificates of deposit in a bank, created in the same way and used for the same purposes as bank deposits.

The Tax Court did not consider the alternative issue as to whether the taxpayer's leasehold improvements constitute facilities within the meaning of Section 444 of the Internal Revenue Code of 1939, Appendix, *infra*, p. 16. The court of appeals, while thinking that the Tax Court had done so, nevertheless itself gave consideration to this alternative claim and held that leasehold improvements were facilities within the meaning of Section 444, and that the taxpayer was not entitled to any relief thereunder. (Pet. App. 39–45.)

ARGUMENT

1. Under the Excess Profits Tax Act of 1950, the excess profits "credit"—*i.e.*, the base figure deemed to represent normal profits—is based on invested capital, which consists of two principal components: "equity capital" and "75 per centum of the average borrowed capital for the taxable year * * *" Section 437(a)(A) and (C). Section 439 defines "average borrowed capital" as the aggregate of the "daily borrowed capital" for each day of the taxable year, divided by the number of days in that year. It then provides, in subsection (b), that "daily borrowed capital" shall be the sum of the "amount of the outstanding indebtedness * * * of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness * * *." Section 40.439–1(f) of the Treasury Regulations issued under the Act, the validity of which is here conceded, defines a certificate of indebtedness to include "only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals," but to exclude from borrowed capital "indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit * * *." The question presented by this case is whether the indebtedness of the petitioner here, evidenced by thrift certificates, falls within the scope of includable borrowed capital as defined by the Act and the Regulations, or whether it falls within the scope of excludable bank deposits.

Although the decision below admittedly conflicts in principle with the decisions of the Tenth Circuit in *Jackson Finance & Thrift Co.* v. *Commissioner*, 260 F. 2d 578 and the Sixth Circuit in *United States* v. *City Loan and Savings Co.*, 287 F. 2d 612, we submit that it is clearly correct and that, in any event, the issue presented is not one which warrants review by this Court.

Our argument with respect to this issue is set forth in our brief in opposition to the petition in No. 447, and we shall not repeat it here except to point out that on the undisputed evidence in the case the taxpayer here, like the taxpayer in No. 447, and like the typical commercial bank, is engaged in the business of receiving deposits and making loans and discounts under strict state regulation akin to the regulation of banks. It conducts that business in the same way as a bank.

The distinctions noted by the Tax Court (R. 50–51) between installment certificates and a bank savings account—that certificates are transferable, can be used as collateral, are signed by the issuer, registered by number, and bear the name of the owner, have limited withdrawability, and do not have the security of cash reserves and insurance—are not substantial. Bank savings accounts are assignable. *Ornbaun* v. *First Nat. Bank*, 215 Cal. 72, 8 P. 2d 470; Zollman, *Banks and Banking* (Permanent ed.), Section 1204. A savings bank passbook can also be used as collateral, and indeed is accepted as collateral for Morris Plan company loans. *Watson* v. *Stockton Morris Plan Co.*, 34 Cal. App. 2d 393, 93 P. 2d 855. Bank passbooks are

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also commonly numbered and carefully recorded, and entries are receipted. The limitations upon the right of redemption of Morris Plan certificates has never been invoked. (R. 186.) Furthermore, taxpayer conceded that under the stringent state regulations applied to it, a Morris Plan company is required to maintain more than ample security for its loans and is regularly audited to insure its solvency. (R. 196.)

The arguments raised by the taxpayer here are, in general, the same as those advanced by the taxpayer in No. 447. As an additional point, however, taxpayer urges that it was entitled to rely upon the Commissioner's acquiescence in *Economy Savings & Loan Co.* v. *Commissioner*, 5 T.C. 543, affirmed on other grounds, 158 F. 2d 472 (C.A. 6th). In that case, the taxpayer, an Ohio savings and loan association engaged in the business of making chattel loans, issued certificates of deposit on monies left with the association for six-month periods. In holding that the amounts represented by these certificates were includable in borrowed capital, the Tax Court expressly avoided deciding whether or not the savings and loan association was in the banking business (5 T.C., p. 552). Instead, it placed its ruling on the ground that a time deposit of six months or more was not an ordinary bank deposit, but was like a Christmas savings account in a bank, which had different legal rights from an ordinary deposit. The Commissioner acquiesced in the decision (1945 Cum. Bull. 3), and did not withdraw his acquiescence until 1959 (1959–1 Cum. Bull. 6–7).

Any reliance the taxpayer may have placed upon the *Economy* decision was plainly unreasonable. In

the first place, the installment certificates here are demand deposits, not time deposits; yet the *Economy* decision rested upon the distinction between the two. Secondly, this distinction between time and demand deposits of a bank, the ground of the *Economy* decision, was expressly overruled by *Commissioner* v. *Ames Tr. & Sav. Bank*, 185 F. 2d 47 (C.A. 8th), reversing 12 T.C. 770; *Capital National Bank of Sacramento* v. *Commissioner*, 16 T.C. 1202; and *National Bank of Commerce* v. *Commissioner*, 16 T.C. 769, which establish the rule, not disputed by the taxpayer, that all deposits in a bank—whether demand deposits, time deposits or savings accounts—are excluded from borrowed capital. As a result of the *Ames* case, decided in 1950, the first of the three tax years involved here, the *Economy* ruling was deprived of controlling force. It is not essential that the acquiescence in a discredited opinion be withdrawn. *Automobile Club* v. *Commissioner*, 353 U.S. 180; *Commissioner* v. *Morgan*, 272 F. 2d 936 (C.A. 9th); *Massaglia* v. *Commissioner*, 286 F. 2d 258 (C.A. 10th). See also *Helvering* v. *Hallock*, 309 U.S. 106.

Moreover, and of the utmost significance here, once the distinction between time and demand deposits, upon which the *Economy* decision was grounded, had been overruled, the sole issue then became whether the taxpayer was a bank. On that issue the precedents were squarely contrary to the taxpayer's position, wholly supporting the proposition that a Morris Plan company is a bank and that moneys placed with it under thrift certificates are deposits in a bank. *Oulton* v. *Savings Institution*, 17 Wall. 109;

Morris Plan Bank of New Haven v. *Smith*, 125 F. 2d 440 (C.A. 2d); *Staunton Industrial L. Corp.* v. *Commissioner*, 120 F. 2d 930 (C.A. 4th); Internal Revenue Code of 1939, Section 104(a)). See also *In re People's Finance & Thrift Co.*, 61 Cal. App. 2d 11, 141 P. 2d 742; *Morris Plan Co.* v. *Johnson*, 37 Cal. App. 2d 621, 100 P. 2d 493; *Savings & Loan Soc.* v. *San Francisco*, 131 Cal. 356, 63 Pac. 665.[3] Under these circumstances, prudent counsel could scarcely have relied upon *Economy*, a distinguishable decision based on questionable grounds.

2. Under Section 444 of the Internal Revenue Code of 1939, Appendix, *infra*, p. 16, the taxpayer here would be entitled to an alternative excess profits tax credit if the unadjusted basis of facilities on December 31, 1949—the close of its base period—were at least 200 per cent of the unadjusted basis of its facilities on December 31, 1946. The taxpayer here cannot show such an increase unless its leasehold improvements are excluded from the base period facilities. Its contention that leasehold improvements are not tangible, depreciable property because a lease is intangible and because the costs are amortized, is wholly without merit. The improvements are physical features of taxpayer's leased place of business. (R.

[3] Indeed, it may be noted that Valley Morris Plan, whose case involves time deposits in the form of term thrift certificates, does not claim reliance upon the *Economy* decision, and the Tax Court itself, in *Jackson Finance & Thrift Co.* v. *Commissioner*, 29 T.C. 272, 278, reversed, 260 F. 2d 578 (C.A. 10th), expressly stated that the *Economy* case was no longer controlling.

259.) The distinctions between amortization and depreciation are not here material; the taxpayer itself, as the court below noted (Pet. App. 44), deducted its costs of the improvements as a depreciation deduction. Moreover, there is no conflict of decision with respect to this issue, and with the repeal of the Excess Profits Tax Act, the question is no longer important.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1962.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

CHAPTER 1—INCOME TAX

* * * * * *

SUBCHAPTER C—SUPPLEMENTAL PROVISIONS

* * * * * *

SEC. 104 [as amended by Sec. 313(h), Revenue Act of 1951, c. 521, 65 Stat. 452]. BANKS AND TRUST COMPANIES.

(a) *Definition.*—As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11(k) of the Federal Reserve Act, 38 Stat. 262 (U.S.C., Title 12, Sec. 248(k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions. Such term also means a domestic building and loan association.

* * * * * *

SUBCHAPTER D—EXCESS PROFITS TAX

* * * * * *

SEC. 436 [as added by Sec. 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137]. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

(a) *General Rule.*—In the case of a domestic corporation (except a corporation described in subsection (b)) the excess profits credit for any taxable year computed under this section shall be the sum of the following:

(1) The invested capital credit computed under section 437, reduced by the amount computed under section 440(b) (relating to inadmissible assets), and

* * * * * * *

SEC. 437 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. INVESTED CAPITAL CREDIT.

* * * * * * *

(b) *Invested Capital.*—

(1) *Election of Taxpayer.*—The invested capital for any taxable year shall be the adjusted invested capital determined under paragraph (2), except that if the taxpayer elects in its return for such taxable year to compute its invested capital under the provisions of section 458, the invested capital for such year shall be the historical invested capital determined under section 458. For the invested capital of certain insurance companies, see paragraph (3).

(2) *Adjusted Invested Capital.*—The adjusted invested capital for any taxable year (hereinafter in this paragraph referred to as "the taxable year") shall be the sum of—

(A) the equity capital (as defined in subsection (c)) as of the beginning of the taxable year;

(B) the capital addition for the taxable year computed under subsection (d);

(C) 75 per centum of the average borrowed capital for the taxable year computed under section 439(a); and

* * * * *

SEC. 439 [as added by Sec. 101, Excess Profits Act of 1950, *supra*]. BORROWED CAPITAL.

(a) *Average Borrowed Capital.*—For the purposes of this subchapter, the average borrowed capital for any taxable year shall be the aggregate of the daily borrowed capital for each day of such taxable year, divided by the number of days in such taxable year.

(b) *Daily Borrowed Capital.*—For the purposes of this subchapter, the daily borrowed capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following:

(1) The amount of the outstanding indebtedness (not including interest) of the taxpayer, incurred in good faith for the purposes of the business, which is evidenced by a bond, note, bill of exchange, debenture, certificate of indebtedness, mortgage, deed of trust, bank loan agreement, or conditional sales contract. In the case of property of the taxpayer subject to a mortgage or other lien, the amount of indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the taxpayer whether or not the taxpayer assumed or agreed to pay such indebtedness, plus

* * * * *

SEC. 444 [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*]. AVERAGE BASE PERIOD NET INCOME—INCREASE IN CAPACITY FOR PRODUCTION OR OPERATION.

(a) *In General.*—If a taxpayer which commenced business on or before the first day of its base period establishes that, during the 36-month period ending on the last day of its base period, there was an increase, as defined in subsection (b), in its capacity for production or operation, the taxpayer's average base period net income determined under this section shall be the amount computed under subsection (c).

(b) *Increase in Capacity.*—An increase in capacity for production or operation shall be deemed to have occurred, for the purposes of this section, if the taxpayer establishes that it made an addition or additions to its facilities (as defined in subsection (d)) or replaced all or a part of its existing facilities, and that:

* * * * *

(3) the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the last day of its base period was 200 per centum or more of the basis (unadjusted) for determining gain upon sale or exchange of its total facilities on the day prior to the beginning of such 36-month period.

* * * * *

(d) *Facilities.*—For the purposes of this section, the term "facilities" means real property and depreciable tangible property, held by the taxpayer in good faith for the purposes of the business.

* * * * *

Treasury Regulations 130, promulgated under the Internal Revenue Code of 1939:

SEC. 40.439–1. *Borrowed capital.* (a) The amount of the average borrowed capital of a corporation shall be computed in the manner provided in section 439(a) and the daily borrowed capital, as defined in sections 439(b) (1), (2), (3), and (4), shall be computed in the manner provided in section 439(b). The average borrowed capital for any taxable year is the aggregate of the daily borrowed capital for each day of the taxable year, divided by the number of days in such taxable year. * * *

* * * * * *

(f) The term "certificate of indebtedness" includes only instruments having the general character of investment securities issued by a corporation as distinguishable from instruments evidencing debts arising in ordinary transactions between individuals. The term "conditional sales contract" means a contract corresponding to a mortgage except that the transfer of title is made dependent upon the payment of the stipulated price. Borrowed capital does not include indebtedness incurred by a bank arising out of the receipt of a deposit and evidenced, for example, by a certificate of deposit, a passbook, a cashier's check, or a certified check, and the term "bank loan agreement" does not include the indebtedness of a bank to a depositor.

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